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SUBJECT: Product Safety Testing, Booming Business in South China

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11. (SBU) Summary: Business is booming for product testing firms in south China. With heightened awareness of product safety risks among manufacturers and stricter enforcement by Chinese authorities, testing firms anticipate continued rapid growth and in some instances are literally working around the clock to meet demand. Chemical and safety testing remain the firms' largest offerings; they are adding new services to further improve quality, generate new business, meet the challenges of competing global safety standards, and enhance their understanding of potential risks posed by innovative and untested products. Even as the role of testing companies increases, executives reiterated that ultimate responsibility for product safety remains with importers. End summary.

Product Testing Industry Sees Rapid China Growth  
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12. (SBU) Last year's toy and other product safety-related recalls of Chinese goods (ref A) substantially increased orders for chemical testing on consumer products at south China's major third-party testing companies. Managers at Intertek, TUV Rheinland, Underwriter's Laboratory (UL), SGS, and Centre Testing International (CTI) all told us recently that they had seen impressive revenue growth in 2007. Executives from U.S. firm Intertek said post-recall testing revenue increased by RMB 50 million (approximately US\$7 million) in late 2007, requiring laboratory staff to work three shifts around the clock.

13. (SBU) Third-party product testing has been an important industry in south China since the area's manufacturing boom began, but growth has taken off in the last 2-3 years. An executive from TUV Rheinland, China's sixth-largest testing firm, told us there are 200-300 product testing firms operating in China. He said multinational testing firms number approximately 30-40, occupying most of the industry's top spots. Chemical testing of consumer products (primarily for compliance with the European RoHS standard and testing for other hazardous materials) and safety testing of household electronics and appliances are the most important sources

of revenue, but testing firms reported a growing customer interest in environmental and automobile testing that was not common in China until very recently.

#### SGS - Industry Leader

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¶4. (SBU) SGS is the largest product testing firm in China, employing 5,000 employees here out of a global workforce of 43,000. Executives at the Swiss firm told us they had seen 15-percent growth in their China operations in 2006. Most testing firms acknowledge that SGS controls the largest market share for RoHS and other chemical testing in China. However, the firm's managers told us they earn more revenue from site inspections, consisting of factory visits and randomized quality testing, as well as pre-shipment inspections at ports and other logistics facilities. SGS executives also reported that fuels and minerals testing are rapidly expanding at key Chinese ports where the bulk of such materials are imported.

#### UL - A Different Model

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¶5. (SBU) Chicago-based Underwriter's Laboratory (UL) takes a different approach to the product testing market. The non-profit corporation controls the largest market share for safety testing of consumer electronics and household appliances. Its business model differs from other companies; it primarily sells licenses to affiliated laboratories and certifying lab results for testing performed at each site (currently more than 50 different UL-certified labs in south China alone). Most UL-certified products are destined for North America. UL has only 7,000 employees worldwide with just 500 in China -- less than half the size of many

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of its multinational competitors. However, it has doubled its south China workforce to 175 in the last year. Executives at UL said that although competition among testing firms is increasing rapidly, the market is also growing so quickly that there is ample room for each company to continue growing with it.

#### CTI - China's Champion

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¶6. (SBU) Centre Testing International (CTI) is widely regarded as the largest Chinese product testing firm, and also the youngest firm among market leaders here. Founded in late 2003, CTI has grown rapidly to more than 1,200 employees working at offices in major cities and ports throughout China. Vice President Paul Nie pointed out that many of CTI's executives have strong backgrounds in product testing, many having worked previously in multinational testing firms.

¶7. (SBU) CTI's Clients include several major multinational companies, even as it seeks to leverage its local-company status and attract more local exporters to purchase testing services. However, Nie emphatically denied that the firm had any investment from the Chinese government or other direct links to the authorities. CTI executives seemed intent on burnishing the company's credentials as an independent third-party testing firm. Multinational firms, by contrast, were eager to highlight their close relationship with the government. Intertek executives noted that their firm was preparing to enter a joint venture with the Guangdong branch of China Inspection and Quarantine Service (CIQ).

#### Challenges of Differing Regulatory Standards

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¶8. (SBU) Variations among regulatory standards continue to pose difficulties for manufacturers, exporters, importers and everyone involved in the supply chain, according to executives at all five testing firms. Compliance with competing toy safety standards in Europe and North America are challenging for anyone involved in that industry, causing many toys to be tested twice for the same types of safety concerns such as drop height or lead content. Textiles were another common concern, with firms complaining about many unique

U.S. quality and safety standards that differ from ISO standards commonly accepted in other countries. Several of the testing companies described participating in standards development with national governments and international standards bodies like ANSI and IECCE, clearly hoping to help move toward more unified global standards.

#### Industry Cooperates to Avoid Duplication

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¶9. (SBU) Executives at several firms highlighted the CB Scheme (Certification Bodies Scheme), managed by a subgroup of the International Electrotechnical Commission (IEC) as an important industry initiative to reduce duplicate testing. Focusing mostly on standards for electrical products and components, the CB Scheme would make it easier for certified testing labs to voluntarily recognize test procedures and data from competitors, reducing costly test duplication as manufacturers share information across laboratories and national borders. As products are introduced to new markets or requirements change, new product testing can supplement prior test results, without the need to duplicate those tests.

#### Testing Companies Expand Offerings

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¶10. (SBU) Testing company executives said innovation in the industry will continue with the development of new technologies and methodologies and the emergence of new safety and quality concerns. Intertek was recently named as a third-party auditor for Wal-Mart Global Procurement's pre-screening of potential manufacturers (ref B). TUV Rheinland described a new proprietary software system designed to help firms improve supply chain security by tracking all components and materials included in products at each stage of production and sales. More companies are ordering testing to check the advertising claims of competitors, according to Intertek's Francis Yuk. Firms found to be making false claims can be significantly

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penalized under U.S. Federal Communications Commission truth-in-advertising regulations. Performance testing is also a major growth area, with manufacturers seeking to test both their own products and their competitors' products, as companies strive to win more sales in diverse global markets.

#### Safety: Risk and Responsibility

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¶11. (SBU) Despite the best efforts of testing companies to ensure products meet the safety and quality standards of importing countries, executives also stressed that the burden of proof and responsibility for failures remain entirely with the importer. Testing company executives pointed out that standards cannot always anticipate safety threats introduced by innovative products, as in last year's Aqua Dots recall (ref C). Instead, manufacturers, importers and testing firms must do their best to anticipate and manage risks, which sometimes includes seeking additional information from outside experts and testing bodies when an innovative product seems to meet existing guidelines but might still pose a previously unidentified risk to consumers.

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